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In the Matter of)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)

Reply Comments of Time Warner Communications Holdings, Inc.

David R. Poe
Catherine P. McCarthy
Yvonne M. Coviello
LeBoeuf, Lamb, Greene
& MacRae, LLP
1875 Connecticut Avenue, NW
Suite 1200
Washington, DC 20009

Economic Consultants:
Susan M. Baldwin
Helen E. Golding
Lee L. Selwyn
Economics and Technology, Inc.
One Washington Mall
Boston, MA 02108

Paul B. Jones
Janis A. Stahlhut
Donald F. Shephard
Time Warner Communications
Holdings, Inc.
300 First Stamford Place
Stamford, CT 06902-6732

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SUMMARY

In its December 19, 1996 comments in response to the Common Carrier Bureau's November 18, 1996 Public Notice¹ issued in this proceeding, Time Warner Communications Holdings, Inc.² ("TW Comm") articulated its support for the Federal-State Joint Board's strenuous efforts to resolve the many difficult issues associated with universal service reform. However, TW Comm emphasized that several key issues necessary to the successful implementation of the universal service goals outlined in the Telecommunications Act of 1996³ are not resolved by the Joint Board's Recommended Decision. TW Comm's comments also noted that some of the Joint Board's recommendations appear to be inconsistent with other recommendations. For those reasons, TW Comm suggested that the Federal Communications Commission ("FCC" or "Commission") exercise its plenary authority and thoroughly analyze the underlying issues before implementing recommendations made by the Joint Board.

¹ The Common Carrier Bureau solicited comments and reply comments on specific issues relating to the Federal-State Joint Board's November 7, 1996 Recommended Decision by Public Notice, DA 96-1891, released November 18, 1996.

² A wholly-owned subsidiary of Time Warner Entertainment Company, L.P.

³ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (to be codified at 47 U.S.C. §§ 151 et seq.) (hereinafter "1996 Act").

In its reply comments, TW Comm recommends that the Commission adopt the following policies:

- issue specific proposals for further comment before adopting a universal service funding mechanism;
- base contributions to the federal universal service fund on carriers' interstate and intrastate revenues;
- rely on a revenue-based threshold to define the threshold against which proxy costs should be compared;
- adopt a basis for the assessment of carriers' contribution to fund federal universal service that is competitively neutral, minimizes opportunities for cross-subsidization, and promotes accountability;
- reject recommendations that all lines be subsidized;
- ensure that subsidies do not flow to geographic areas with high-income households;
- address any changes to the subscriber line charge or the carrier common line charge in the access charge reform proceeding;
- take steps to control the overall cost of the fund; and
- take steps to ensure that it makes accurate determinations about which carriers should be considered rural carriers for universal service purposes.

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INTRODUCTION

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6 In the Matter of Federal-State Joint Board on Universal
Service, Recommended Decision, CC Docket No. 96-45 (released

to conform to the dictates of the Telecommunications Act of 1996⁷, and TW Comm by and large supported those efforts.

However, TW Comm also emphasized that although the RD provides the Federal Communications Commission ("FCC" or "Commission") with significant guidance regarding the implementation of the goals of Section 254 of the 1996 Act, the Commission must complete an independent and thorough analysis of the underlying issues before implementing the RD's proposals.

In general, comments of other parties likewise supported the concept that Commission efforts must harmonize the most significant of the RD's inconsistencies, clarify those recommendations that are not readily interpretable, and reach determinations regarding those unresolved issues that are central to achieving universal service objectives. In response to the comments received from other parties, TW Comm herein respectfully proffers clarifications and/or constructive suggestions to the Commission regarding the establishment of a workable universal service fund as intended by Section 254 of the 1996 Act. The purpose of these reply comments is to provide assistance to the Commission in dealing with the complexities of the issues.

November 8, 1996) (hereinafter "Recommended Decision").

⁷ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (to be codified at 47 U.S.C. §§ 151 et seq.) (hereinafter "1996 Act").

I. The Commission should issue specific proposals for further comment before adopting a universal service funding mechanism.

Before implementing the Joint Board's recommendations, the Commission must reach adequate resolution of those determinations vital to the implementation of a workable universal service fund that the Joint Board's RD did not resolve. As the New York Public Service Commission ("NYPSC") notes in its comments, the Commission should issue specific details of how it proposes to resolve these vital issues and provide additional opportunity for comment on its proposals prior to commencing the implementation process.⁸ It is particularly important for the Commission to provide an opportunity for further comment at a later date because at this juncture, it is impossible to reach conclusions on many issues relating to implementation of the fund due to the unresolved issues related to the uncertainties about which cost proxy model approach the Commission will adopt.

Despite TW Comm's support for the NYPSC's suggestion that the Commission issue specific proposals for further comment before adopting a universal service funding mechanism, TW Comm does not support the NYPSC's proposal that the Commission establish an interim high-cost funding mechanism. Such an

⁸ Comments of the New York State Department of Public Service on the Recommended Decision of the Federal-State Joint Board on Universal Service ("NYPSC Comments") at 8-10.

approach would increase the administrative burden placed upon the Commission, unnecessarily making an already complex process even more complicated. Moreover, existing mechanisms sufficiently cover current universal service requirements and do not need to be supplemented during the period in which the proposed interim mechanism could conceivably be in effect.

II. Contributions to the federal USF should be based upon carriers' interstate and intrastate revenues.

In the comments on the RD, a broad array of parties (in addition to TW Comm) recognize the desirability of basing contributions to the federal universal service fund on carriers' combined interstate and intrastate revenues.⁹ These parties, collectively, point out that the use of combined revenues is more competitively neutral and equitable than using interstate revenues alone. The comments supporting this approach demonstrate that the inclusion of intrastate revenues is completely consistent with the legislative mandate for a broadly

⁹ See, e.g., Comments of the National Cable Television Association, Inc. ("NCTA") at 28-29; Comments of AT&T Corp. ("AT&T Comments") at 5-8; Comments of the United States Telephone Association ("USTA Comments") at 17-18; GTE's Comments ("GTE Comments") at 65-70; MCI Telecommunications Corporation Comments ("MCI Comments") at 10-11; BellSouth Corporation and BellSouth Telecommunications, Inc. Comments on the Universal Service Recommended Decision ("BellSouth Comments") at 9-10; Response of U S West, Inc. to Recommended Decision ("U S West Comments") at 16-21; Comments of the Association for Local Telecommunications Services ("ALTS Comments") at 11-13.

supported federal universal service fund mechanism. Moreover, several parties provide detailed examples of why it would be cumbersome and unreliable to introduce jurisdictional separations issues into the process of identifying assessable revenues for the purpose of a universal service funding mechanism.¹⁰

The primary detractors of this approach – several of the incumbent local exchange carriers ("ILECs") plus a number of state public utility commissions – take the narrow view that the Commission lacks jurisdiction to base any portion of the funding obligation for federal universal service support mechanisms on intrastate revenues.¹¹ These parties urge a strictly bifurcated view of the 1996 Act's universal service funding mechanism, with intrastate revenue tied exclusively to state-administered universal service mechanisms and interstate revenue as the sole basis for any federal universal service support. As the comments of numerous parties explain in detail, the 1996 Act does not require such a constrained result and, in fact, grants to the FCC broad discretion to assess all providers of interstate telecommunications services with regard to all of their revenues,

¹⁰ BellSouth Comments at 10; NCTA Comments at 31-32.

¹¹ See, e.g., NYNEX Comments on Joint Board Recommendation ("NYNEX Comments") at 13-20; NYPSC Comments at 4-7; Comments of Bell Atlantic ("Bell Atlantic Comments") at 3-10; Comments of SBC Communications Inc. in Response to Public Notice of November 18, 1996 ("SBC Comments") at 14-18.

both intrastate and interstate.¹² Also, contrary to the position taken by some ILECs,¹³ it is neither equitable nor consistent with the objectives of the 1996 Act to put a largely disproportionate share of universal service funding responsibility on providers of interstate services (primarily the interexchange carriers ("IXCs")), while minimizing the obligation of the ILECs.

III. A revenue-based threshold is an indicator of affordability and also appropriately recognizes the substantial stream of revenues that are inextricably linked to basic local exchange service.

The Joint Board carefully considered a number of different approaches to define the "benchmark" or "threshold" against which proxy costs should be compared in order to identify eligibility for high-cost support and chose to endorse a benchmark based on national average revenues per line. In its comments, TW Comm set forth in detail its rationale for supporting the type of revenue-based benchmark proposed by the Joint Board, as opposed to various alternative approaches

¹² See, e.g., AT&T Comments at 5-8; U S West Comments at 17-18; BellSouth Comments at 10 n.25; Comments of Pacific Telesis Group ("Pacific Telesis Comments") at 7-8.

¹³ NYNEX goes so far as to assert that Congress "probably had the existing IXCs in mind" as the primary contributors to federal universal service support. NYNEX Comments at 19. There is absolutely no substantiation for this claim.

considered and rejected by the Joint Board.¹⁴

Since universal service support is aimed at ensuring that carriers are able economically to offer service to customers at an affordable rate, there is no reason to subsidize a carrier who is (or is capable of) generating revenues that exceed the cost of providing service. For this reason, the revenue benchmark should include all revenues inextricably linked to basic telephone service. Thus, in addition to revenues from basic local service and discretionary services, the benchmark should also reflect other revenues that are indisputably linked to the provision of exchange service to the customer, including revenues from imputed switched access on all toll calls, revenues from second lines, and, exclusively in the case of ILECs, revenues from Yellow Pages operations. While a revenue-based threshold should be used as the primary basis for determining an entitlement to high-cost support, TW Comm also explained why income levels in the geographic area for which universal service support is sought should also be considered before any universal service support is disbursed.

A number of parties continue to urge alternative

¹⁴ Comments of Time Warner Communications Holdings, Inc. ("TW Comm Comments") at 14-32. Other parties supporting the use of revenue benchmark include Teleport Communications Group, Inc. ("Teleport"), Teleport Comments at 6-7, and ALTS, ALTS Comments at 8.

approaches including (1) a cost-based threshold,¹⁵ (2) an income-based threshold,¹⁶ and (3) a "federal funding benchmark," set at a \$30 level.¹⁷ While each of these approaches has some merit, they each critically fail with respect to recognizing the revenue side of the universal service equation. Several parties indicate a willingness to support a revenue-based benchmark, but without the inclusion of access and discretionary revenues.¹⁸ These parties argue that including the revenues from discretionary and access services perpetuates implicit subsidies and is, therefore, inconsistent with the principles of TA-96.¹⁹ While TW Comm recognizes that relying on revenues from services that are priced significantly above their costs perpetuates some implicit subsidies that exist today, the solution to this dilemma lies in

¹⁵ See, e.g., Comments of MFS Communications Company, Inc. ("MFS Comments") at 24.

¹⁶ See, e.g., BellSouth Comments at 12-14; USTA Comments at 11.

¹⁷ U S West Comments at 28.

¹⁸ See, e.g., Pacific Telesis Comments at 17; MCI Comments at 9-10.

¹⁹ USTA (which supports an income-based approach) argues against a revenue benchmark on the ground that the ILECs' higher-revenue customers (those generating above-average discretionary and access revenues) will be "targeted" by competitors. USTA Comments at 11. However, there is no reason to assume that ILECs will be less able to vie successfully for high-revenue customers than their competitors.

rate rebalancing, not in disregarding the existence of the revenues from discretionary and access services.

The revenue "benchmark" serves two purposes: first, it reflects the amount of money that customers are willing to spend on telephone service and thus, is an indicator of affordability, and second, it recognizes that today, ILECs receive a stream of revenues that is inextricably linked with the provision of a customer's exchange service and which is not likely to be eroded to any significant extent by competition for the foreseeable future.

IV. The basis for the assessment of carriers' contribution to fund federal universal service should be competitively neutral, minimize opportunities for cross-subsidization, and promote accountability.

One of the many issues that the Commission must resolve in this proceeding is the basis for the assessment of carriers' contribution to fund universal service. The criteria that should guide this decision include: efficiency in the supply and purchasing of telecommunications services; fairness; administrative simplicity; accountability; and competitive neutrality.²⁰ Two mechanisms are supported by various parties in

²⁰ Clearly the relevant statutory requirements (such as requiring all carriers to contribute to the universal service fund on an equitable and nondiscriminatory basis and for "specific, predictable, and sufficient mechanisms") must also govern the ultimate determination of the way in which carriers

the initial comments addressing the Joint Board's RD: (1) a mechanism under which contributions would be based upon a carrier's gross telecommunications revenues net of its payments to other carriers, and (2) a mechanism pursuant to which contributions would be based upon a carrier's retail revenues. The Joint Board recommended the former mechanism, i.e., that contributions be based upon a "carrier's gross telecommunications revenues net of payments to other carriers."²¹ Some parties strongly endorsed the Joint Board's recommendation,²² while others advocated the use of retail revenues as the basis of the contribution.²³

The Commission must analyze the extent to which it matters which of the two methods it adopts. One consideration is whether one mechanism yields a more economically efficient and/or fair outcome than the other mechanism. The selection of the mechanism will affect the relative share of a carrier's direct contribution to the fund and thus, at first glance, the choice of

are assessed. 1996 Act at § 254(d).

²¹ Recommended Decision at para. 807.

²² See, e.g., NCTA Comments at 14; Teleport Comments at 11.

²³ See, e.g., U S West Comments at 45-47; USTA Comments at 15-16; Bell Atlantic Comments at 8; NYNEX Comments at 18; SBC Comments at 17-18.

the assessment method appears to be very significant. For example, under the approach recommended by the Joint Board, an ILEC would be assessed for all of its revenues (including access revenues) because an ILEC does not make any payments to other carriers, and, under the alternative approach, an ILEC would be assessed only on its retail revenues. Thus, under the later approach, an ILEC's substantial access revenues would not comprise a component of the basis of the assessment.

However, contrary to the assertions of SBC Communications, Inc. ("SBC"), which contends that the Joint Board's recommendation "clearly favors those carriers that rely upon another carrier's network to provide service in that the facilities-based carriers shoulder a greater proportion of universal service funding,"²⁴ it is the customers who ultimately "shoulder" the funding regardless of which carrier is assessed. The customers ultimately "shoulder" the funding because regardless of where the assessment is imposed, the cost will be passed through. The difference, thus, is a superficial one, and simply reflects the relative roles of the carriers as collectors of the assessments that ultimately – under either mechanism – will be recovered from customers. The size of the fund is unaffected by which carriers are assessed, and the cost of the

²⁴ SBC Comments at 16.

assessment will be passed on to customers, regardless of where in the "production" stream the assessment is imposed.

TW Comm concurs with U S West, Inc. ("U S West") that assuming all providers can raise their prices to recover the universal service fund assessment, the retail method and the gross revenue net of payments method yield the same result.²⁵ This conclusion is supported by the economic literature on public finance and taxation.²⁶ The difference is simply whether the "tax" is collected at the final point of sale (i.e., the retail method) or collected at each of the stages of production (the gross revenues net of payment approach). If ILECs collect a relatively greater share of the universal service fund (that is, if the Commission adopts the Joint Board's proposed assessment basis), then the result will be that IXC's and new entrants will meet their universal service fund obligation through the payment of relatively higher prices to ILECs for wholesale services. If new entrants and IXC's have a larger role in collecting the federal universal service funding requirements (that is, if the

²⁵ U S West Comments at 44.

²⁶ See, e.g., Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice, 330-331, 337-341 (McGraw Hill 1976). See also Harvey S. Rosen, Public Finance, 496 (Irwin 1992).

retail method is adopted), the prices that ILECs charge for their wholesale services will be relatively less.

The United States Telephone Association ("USTA") contends that the Joint Board's recommendation would be discriminatory and unfair because other carriers would be allowed to exclude payments for transport services that the carriers use but that the ILECs provide.²⁷ USTA's claim that this outcome would unfairly burden ILECs²⁸ is unconvincing because, as discussed above, ILECs will recover the costs from their customers (including those purchasing the ILECs' wholesale services). Thus, USTA's "logic" should not be the rationale adopted by the Commission for rejecting the use of gross revenues net payments approach. Based upon the reasons discussed above, the two assessment mechanisms achieve the goals of economic efficiency or fairness to the same degree. Therefore, the Commission should consider other criteria for selecting between the approaches.

USTA claims that the use of retail revenues as the basis of assessment would be administratively simple in comparison with the gross revenues net of payment method which, according to USTA, would entail the difficult task of tracking

²⁷ USTA Comments at 15-16.

²⁸ Id. at 16.

and verifying payments to other carriers.²⁹ Clearly the two mechanisms differ in the way that the Commission would audit the basis of contributions to the universal service fund, and it is appropriate for the Commission to consider the goal of administrative simplicity as it selects between the two alternative methods of assessment. In its RD, the Joint Board indicates that "the Commission would have difficulty tracking and verifying carrier retail revenues because it has not previously compiled data on that basis."³⁰ If the Commission could track gross revenues net of payments, the Commission could also track one of the components, that is gross revenues (which includes retail revenues).

A distinct but equally important methodological issue concerns the way carriers will recover the universal service fund assessment from their customers, e.g., directly, through an explicit line item on a bill, or indirectly, through the prices they set for their various services. The initial comments reflect substantial support for the use of an explicit surcharge on end users' bills. Some comments suggest that the Commission allow local exchange carriers to recover their universal service

²⁹ Id.

³⁰ Recommended Decision at para. 811.

fund contributions through an explicit surcharge.³¹ Others recommend that the Commission require this recovery mechanism.³²

As AT&T Corp. ("AT&T") aptly describes, the Commission should require universal service contributions to be reflected as a surcharge on end user bills "because it would prevent carriers from structuring their rates to strategically allocate the cost of the subsidy among their various services to the disadvantage of consumers and competitors."³³ TW Comm agrees with AT&T's suggestion that carriers be prohibited from exercising discretion in the way that they recover universal service fund contributions. Accordingly, TW Comm recommends that regardless of whether it adopts the gross revenues net of payments or the retail method of assessment, the Commission should require ILECs to reflect their universal service fund contributions explicitly on the relevant bills.³⁴ Further, TW Comm concurs with U S West

³¹ See, e.g., NYNEX Comments at 5. NYNEX suggests that because CLECs and IXC are non-regulated "they are free to use a surcharge or any other pricing mechanism to recover their universal service contributions from end users." Id. at 5 n.6.

³² See, e.g., AT&T Comments at i; SBC Comments at 11.

³³ AT&T Comments at i-ii.

³⁴ See Id. at 9 n.5. Under the gross revenues net of payments approach, the assessment would be recovered not only from end users, but also from other carriers, e.g., on the bill rendered by an ILEC to an IXC for access services; under the retail approach, the assessment would be recovered only through charges to end users.

that requiring carriers to identify the universal service fund assessment on the end user's bill is consistent with the 1996 Act's requirement that universal service fund be treated explicitly.³⁵ TW Comm also concurs with NYNEX that an explicit surcharge on end users' bills would identify to consumers the portion of their payment that relates to universal service obligations.³⁶ In order to maximize accountability to the customer (who ultimately bears the cost of the universal service fund), and in order to minimize ILECs' ability to recover the costs of the universal service assessment disproportionately from monopoly services,³⁷ TW Comm recommends the use of a line item on customers' bills that reflects explicitly the recovery of the universal service fund assessment.

In summary, an evaluation of the relative merits of the two assessment mechanisms indicates that the major differentiating characteristics are those of administrative simplicity and accountability. As discussed above, the two methods yield the same results regarding the achievement of

³⁵ U S West Comments at 45-47. See also MFS Comments at 12-13 (recommending that universal service support be reflected explicitly through a line item entry on customers' bills).

³⁶ NYNEX Comments at 5.

³⁷ The prevention of this type of discretion comports with the important principle of competitive neutrality.

economic efficiency and equity. Although the Joint Board raises a concern about the Commission's ability to track retail revenues, TW Comm is not persuaded that retail revenues would be more difficult to audit than gross revenues net of payments. The use of retail revenues as the assessment basis and the use of explicit line items on ILECs' bill as the recovery mechanism achieves accountability because the full universal service fund assessment will appear on end users' bills. By contrast, under the gross revenues net of payments approach, the universal service fund would be recovered on line items on bills rendered to end users (by all providers) and on bills rendered to other telecommunications providers (those purchasing wholesale services from ILECs). Under this mechanism, the telecommunications provider of service to the end user would still recover the full assessment from the end user in the form of an explicit surcharge. However, only the amount based on net revenues would be passed on to the fund administrator. The remainder would compensate the telecommunications provider for the universal service fund surcharge included in its bill for wholesale services.³⁸

³⁸ TW Comm supports the explicit line item requirement, regardless of the assessment method selected by the Commission. Since both mechanisms yield the same result, it would appear that the "pure retail" mechanism would be administratively simpler.

V. The FCC should reject USTA's recommendation that all lines be subsidized because it is unnecessary as a practical matter and contrary to the public interest.

USTA recommends that universal service funds subsidize all lines "to minimize administrative burdens."³⁹ USTA raises the concern that it will be unclear which carrier will receive support if more than one carrier provides local exchange service to a given household. The universal service fund should be administered to preclude double-counting of high cost support. However, the subsidization of additional lines is unnecessary to achieve national universal service goals and would inhibit competition by inappropriately raising the size of the universal service fund. Thus, subsidizing all lines would be adverse to the public interest. Administratively, the Commission must resolve two issues. The first is how to redirect universal service fund support when a customer switches from the ILEC to a new entrant (or makes any other subsequent change in the provider of his primary exchange access line), so that multiple carriers do not "claim" the same customer for purposes of the universal service fund calculations. The second is how to identify which line is the "primary" line (associated with universal service support) and which is an additional line.

³⁹ USTA Comments at 30-31.

These administrative issues, while not inconsequential, may be solved without distorting the calculation of universal service fund requirements. One possible solution would be to require customers to declare which line is their "primary" line. Another possible solution would be the use of a customer voucher - one per household in an eligible area. Using this approach, a customer's migration from one carrier to another would not require any action on the part of the fund administrator. Also, it would not matter which of the multiple carriers serving the high-cost customer was providing the primary line and which was providing a second line. TW Comm recognizes that a voucher approach is not without problems and certainly, it is not the only way to address these administrative issues. However, TW Comm is confident that carriers can work together with the fund administrator to address such administrative issues in order to avoid a "solution" that adds unnecessary and uneconomic support requirements to the universal service fund.

VI. The access charge reform proceeding is the appropriate docket to address any changes to the subscriber line charge or the carrier common line charge.

TW Comm supports Commission efforts to reform the structure of access charges. TW Comm also recognizes that the Commission will need to coordinate the outcome of its access

reform efforts with the outcome of the universal service proceeding. However, TW Comm agrees with those comments suggesting that it is appropriate for the Commission to address any changes to the Carrier Common Line Charge ("CCLC") or the Subscriber Line Charge ("SLC") in the access charge reform proceeding.⁴⁰ As MFS Communications Company, Inc. recognized, reform of the CCLC is not "an issue that is properly addressed in this docket. Reform of carrier common line charges should be part of the comprehensive access reforms that the Commission has committed to undertake"⁴¹ Teleport Communications Group also realized that "the SLC and the CCLC will be better addressed in the access charge reform docket, not the universal service docket."⁴²

TW Comm concurs with opposition to the Joint Board's recommendation that the Commission reduce the SLC.⁴³ This is an

⁴⁰ In re Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; and Usage of the Public Switched Network by Information Service and Internet Access Providers, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, CC Docket Nos. 96-262, 94-1, 91-213, and 96-263 (released December 24, 1996).

⁴¹ MFS Comments at 34.

⁴² Teleport Comments at 10-11.

⁴³ See, e.g., U S West Comments at 21-23; GTE Comments at 40-41; MCI Comments at 14-16.

issue more appropriately taken up in the context of access charge reform. The consumer groups that support proposals to reduce or to freeze the SLC, such as the comments filed by the National Association of State Utility Consumer Advocates, are misguided.⁴⁴ A reduction to the SLC may result in a realization of Commissioner Chong's prediction that "[a]ny potential savings that consumers would receive from a SLC reduction on their local phone bills may well be offset by an increase to their long distance bills."⁴⁵ Further, as AT&T expressed in its comments, lowering the SLC might unnecessarily increase universal service fund revenue requirements.⁴⁶

VII. The Commission should take steps to control the overall cost of the fund.

TW Comm supports those comments advocating that the Commission take steps to control the overall cost of the fund.⁴⁷ The levels of high-cost support currently under consideration are excessive, anticompetitive, and unjustified. Thus, any funding

⁴⁴ See Comments of the National Association of State Utility Consumer Advocates (NASUCA) on the Recommended Decision of the Federal-State Joint Board at 2-9.

⁴⁵ Recommended Decision, Separate Statement of Commissioner Chong at 12.

⁴⁶ AT&T Comments at 12-13.

⁴⁷ See, e.g., AT&T Comments at 14-15; MFS Comments at 14-16.